

granted) for the estate of the transferor; and

(C) Either—

(J) The new trusts are severed on a fractional basis. If severed on a fractional basis, the separate trusts need not be funded with a pro rata portion of each asset held by the undivided trust. The trusts may be funded on a nonpro rata basis provided funding is based on either the fair market value of the assets on the date of funding or in a manner that fairly reflects the net appreciation or depreciation in the value of the assets measured from the valuation date to the date of funding; or

(2) If the severance is required (by the terms of the governing instrument) to be made on the basis of a pecuniary amount, the pecuniary payment is satisfied in a manner that would meet the requirements of paragraph (a)(1)(ii) of this section if it were paid to an individual.

(2) *Special rule.* If a court order severing the trust has not been issued at the time the Federal estate tax return is filed, the executor must indicate on a statement attached to the return that a proceeding has been commenced to sever the trust and describe the manner in which the trust is proposed to be severed. A copy of the petition or other instrument used to commence the proceeding must also be attached to the return. If the governing instrument of a trust or local law authorizes the severance of the trust, a severance pursuant to that authorization is treated as meeting the requirement of paragraph (b)(1)(ii)(B) of this section if the executor indicates on the Federal estate tax return that separate trusts will be created (or funded) and clearly sets forth the manner in which the trust is to be severed and the separate trusts funded.

(3) *Allocation of exemption.* An individual's GST exemption under §2632 may be allocated to the separate trusts created pursuant to this section at the discretion of the executor or trustee.

(4) *Examples.* The following examples illustrate the provisions of this section (b):

Example 1. Severance of single trust. T's will establishes a testamentary trust providing that income is to be paid to T's spouse for

life. At the spouse's death, one-half of the corpus is to be paid to T's child, C, or C's estate (if C fails to survive the spouse) and one-half of the corpus is to be paid to T's grandchild, GC, or GC's estate (if GC fails to survive the spouse). If the requirements of paragraph (b) of this section are otherwise satisfied, T's executor may divide the testamentary trust equally into two separate trusts, one trust providing an income interest to spouse for life with remainder to C, and the other trust with an income interest to spouse for life with remainder to GC. Furthermore, if the requirements of paragraph (b) of this section are satisfied, the executor or trustee may further divide the trust for the benefit of GC. GST exemption may be allocated to any of the divided trusts.

Example 2. Severance of revocable trust. T creates an inter vivos revocable trust providing that, at T's death and after payment of all taxes and administration expenses, the remaining corpus will be divided into two trusts. One trust, for the benefit of T's spouse, is to be funded with the smallest amount that, if qualifying for the marital deduction, will reduce the estate tax to zero. The other trust, for the benefit of T's descendants, is to be funded with the balance of the revocable trust corpus. The trust corpus is includible in T's gross estate. Each trust is recognized as a separate trust for purposes of chapter 13.

[T.D. 8644, 60 FR 66903, Dec. 27, 1995; 61 FR 29654, June 12, 1996, as amended at 61 FR 43656, Aug. 26, 1996]

26.2662-1 Generation-skipping transfer tax return requirements.

(a) *In general.* Chapter 13 imposes a tax on generation-skipping transfers (as defined in section 2611). The requirements relating to the return of tax depend on the type of generation-skipping transfer involved. This section contains rules for filing the required tax return. Paragraph (c)(2) of this section provides special rules concerning the return requirements for generation-skipping transfers pursuant to certain trust arrangements (as defined in paragraph (c)(2)(ii) of this section), such as life insurance policies and annuities.

(b) *Form of return—(1) Taxable distributions.* Form 706GS(D) must be filed in accordance with its instructions for any taxable distribution (as defined in section 2612(b)). The trust involved in a transfer described in the preceding sentence must file Form 706GS(D-1) in accordance with its instructions. A copy

of Form 706GS(D-1) shall be sent to each distributee.

(2) *Taxable terminations.* Form 706GS(T) must be filed in accordance with its instructions for any taxable termination (as defined in section 2612(a)).

(3) *Direct skip*—(i) *Inter vivos direct skips.* Form 709 must be filed in accordance with its instructions for any direct skip (as defined in section 2612(c)) that is subject to chapter 12 and occurs during the life of the transferor.

(ii) *Direct skips occurring at death*—(A) *In general.* Form 706 or Form 706NA must be filed in accordance with its instructions for any direct skips (as defined in section 2612(c)) that are subject to chapter 11 and occur at the death of the decedent.

(B) *Direct skips payable from a trust.* Schedule R-1 of Form 706 must be filed in accordance with its instructions for any direct skip from a trust if such direct skip is subject to chapter 11. See paragraph (c)(2) of this section for special rules relating to the person liable for tax and required to make the return under certain circumstances.

(c) *Person liable for tax and required to make return*—(1) *In general.* Except as otherwise provided in this section, the following person is liable for the tax imposed by section 2601 and must make the required tax return—

(i) The transferee in a taxable distribution (as defined in section 2612(b));

(ii) The trustee in the case of a taxable termination (as defined in section 2612(a));

(iii) The transferor (as defined in section 2652(a)(1)(B)) in the case of an inter vivos direct skip (as defined in section 2612(c));

(iv) The trustee in the case of a direct skip from a trust or with respect to property that continues to be held in trust; or

(v) The executor in the case of a direct skip (other than a direct skip described in paragraph (c)(1)(iv) of this section) if the transfer is subject to chapter 11. See paragraph (c)(2) of this section for special rules relating to direct skips to or from certain trust arrangements (as defined in paragraph (c)(2)(ii) of this section).

(2) *Special rule for direct skips occurring at death with respect to property*

held in trust arrangements—(i) *In general.* In the case of certain property held in a trust arrangement (as defined in paragraph (c)(2)(ii) of this section) at the date of death of the transferor, the person who is required to make the return and who is liable for the tax imposed by chapter 13 is determined under paragraphs (c)(2)(iii) and (iv) of this section.

(ii) *Trust arrangement defined.* For purposes of this section, the term *trust arrangement* includes any arrangement (other than an estate) which, although not an explicit trust, has the same effect as an explicit trust. For purposes of this section, the term “explicit trust” means a trust described in §301.7701-4(a).

(iii) *Executor’s liability in the case of transfers with respect to decedents dying on or after June 24, 1996 if the transfer is less than \$250,000.* In the case of a direct skip occurring at death, the executor of the decedent’s estate is liable for the tax imposed on that direct skip by chapter 13 and is required to file Form 706 or Form 706NA (and not Schedule R-1 of Form 706) if, at the date of the decedent’s death—

(A) The property involved in the direct skip is held in a trust arrangement; and

(B) The total value of the property involved in direct skips with respect to the trustee of that trust arrangement is less than \$250,000.

(iv) *Executor’s liability in the case of transfers with respect to decedents dying prior to June 24, 1996 if the transfer is less than \$100,000.* In the case of a direct skip occurring at death with respect to a decedent dying prior to June 24, 1996, the rule in paragraph (c)(2)(iii) of this section that imposes liability upon the executor applies only if the property involved in the direct skip with respect to the trustee of the trust arrangement, in the aggregate, is less than \$100,000.

(v) *Executor’s right of recovery.* In cases where the rules of paragraphs (c)(2)(iii) and (iv) of this section impose liability for the generation-skipping transfer tax on the executor, the executor is entitled to recover from the trustee (if the property continues to be held in trust) or from the recipient of the property (in the case of a transfer

from a trust), the generation-skipping transfer tax attributable to the transfer.

(vi) *Examples.* The following examples illustrate the application of this paragraph (c)(2) with respect to decedents dying on or after June 24, 1996:

Example 1. Insurance proceeds less than \$250,000. On August 1, 1997, T, the insured under an insurance policy, died. The proceeds (\$200,000) were includible in T's gross estate for Federal estate tax purposes. T's grandchild, GC, was named the sole beneficiary of the policy. The insurance policy is treated as a trust under section 2652(b)(1), and the payment of the proceeds to GC is a transfer from a trust for purposes of chapter 13. Therefore, the payment of the proceeds to GC is a direct skip. Since the proceeds from the policy (\$200,000) are less than \$250,000, the executor is liable for the tax imposed by chapter 13 and is required to file Form 706.

Example 2. Aggregate insurance proceeds of \$250,000 or more. Assume the same facts as in Example 1, except T is the insured under two insurance policies issued by the same insurance company. The proceeds (\$150,000) from each policy are includible in T's gross estate for Federal estate tax purposes. T's grandchild, GC1, was named the sole beneficiary of Policy 1, and T's other grandchild, GC2, was named the sole beneficiary of Policy 2. GC1 and GC2 are skip persons (as defined in section 2613). Therefore, the payments of the proceeds are direct skips. Since the total value of the policies (\$300,000) exceeds \$250,000, the insurance company is liable for the tax imposed by chapter 13 and is required to file Schedule R-1 of Form 706.

Example 3. Insurance proceeds of \$250,000 or more held by insurance company. On August 1, 1997, T, the insured under an insurance policy, dies. The policy provides that the insurance company shall make monthly payments of \$750 to GC, T's grandchild, for life with the remainder payable to T's great grandchild, GGC. The face value of the policy is \$300,000. Since the proceeds continue to be held by the insurance company (the trustee), the proceeds are treated as if they were transferred to a trust for purposes of chapter 13. The trust is a skip person (as defined in section 2613(a)(2)) and the transfer is a direct skip. Since the total value of the policy (\$300,000) exceeds \$250,000, the insurance company is liable for the tax imposed by chapter 13 and is required to file Schedule R-1 of Form 706.

Example 4. Insurance proceeds less than \$250,000 held by insurance company. Assume the same facts as in Example 3, except the policy provides that the insurance company shall make monthly payments of \$500 to GC and that the face value of the policy is \$200,000. The transfer is a transfer to a trust for purposes of chapter 13. However, since

the total value of the policy (\$200,000) is less than \$250,000, the executor is liable for the tax imposed by chapter 13 and is required to file Form 706.

Example 5. On August 1, 1997, A, the insured under a life insurance policy, dies. The insurance proceeds on A's life that are payable under policies issued by Company X are in the aggregate amount of \$200,000 and are includible in A's gross estate. Because the proceeds are includible in A's gross estate, the generation-skipping transfer that occurs upon A's death, if any, will be a direct skip rather than a taxable distribution or a taxable termination. Accordingly, because the aggregate amount of insurance proceeds with respect to Company X is less than \$250,000, Company X may pay the proceeds without regard to whether the beneficiary is a skip person in relation to the decedent-transferor.

(3) *Limitation on personal liability of trustee.* Except as provided in paragraph (c)(3)(iii) of this section, a trustee is not personally liable for any increases in the tax imposed by section 2601 which is attributable to the fact that—

(i) A transfer is made to the trust during the life of the transferor for which a gift tax return is not filed; or

(ii) The inclusion ratio with respect to the trust, determined by reference to the transferor's gift tax return, is erroneous, the actual inclusion ratio being greater than the reported inclusion ratio.

(iii) This paragraph (c)(3) does not apply if the trustee has or is deemed to have knowledge of facts sufficient to reasonably conclude that a gift tax return was required to be filed or that the inclusion ratio is erroneous. A trustee is deemed to have knowledge of such facts if the trustee's agent, employee, partner, or co-trustee has knowledge of such facts.

(4) *Exceptions—(i) Legal or mental incapacity.* If a distributee is legally or mentally incapable of making a return, the return may be made for the distributee by the distributee's guardian or, if no guardian has been appointed, by a person charged with the care of the distributee's person or property.

(ii) *Returns made by fiduciaries.* See section 6012(b) for a fiduciary's responsibilities regarding the returns of decedents, returns of persons under a disability, returns of estates and trusts, and returns made by joint fiduciaries.

(d) *Time and manner of filing return*—(1) *In general.* Forms 706, 706NA, 706GS(D), 706GS(D-1), 706GS(T), 709, and Schedule R-1 of Form 706 must be filed with the Internal Revenue Service office with which an estate or gift tax return of the transferor must be filed. The return shall be filed—

(i) *Direct skip.* In the case of a direct skip, on or before the date on which an estate or gift tax return is required to be filed with respect to the transfer (see section 6075(b)(3)); and

(ii) *Other transfers.* In all other cases, on or before the 15th day of the 4th month after the close of the calendar year in which such transfer occurs. See paragraph (d)(2) of this section for an exception to this rule when an election is made under section 2624(c) to value property included in certain taxable terminations in accordance with section 2032.

(2) *Exception for alternative valuation of taxable termination.* In the case of a taxable termination with respect to which an election is made under section 2624(c) to value property in accordance with section 2032, a Form 706GS(T) must be filed on or before the 15th day of the 4th month after the close of the calendar year in which the taxable termination occurred, or on or before the 10th month following the month in which the death that resulted in the taxable termination occurred, whichever is later.

(e) *Place for filing returns.* See section 6091 for the place for filing any return, declaration, statement, or other document, or copies thereof, required by chapter 13.

(f) *Lien on property.* The liens imposed under sections 6324, 6324A, and 6324B are applicable with respect to the tax imposed under chapter 13. Thus, a lien under section 6324 is imposed in the amount of the tax imposed by section 2601 on all property transferred in a generation-skipping transfer until the tax is fully paid or becomes uncollectible by reason of lapse of time. The lien attaches at the time of the generation-skipping transfer and is in addition to the lien for taxes under section 6321.

[T.D. 8644, 60 FR 66903, Dec. 27, 1995; 61 FR 29654, June 12, 1996]

§ 26.2663-1 Recapture tax under section 2032A.

See § 26.2642-4(a)(4) for rules relating to the recomputation of the applicable fraction and the imposition of additional GST tax, if additional estate tax is imposed under section 2032A.

§ 26.2663-2 Application of chapter 13 to transfers by nonresidents not citizens of the United States.

(a) *In general.* This section provides rules for applying chapter 13 of the Internal Revenue Code to transfers by a transferor who is a nonresident not a citizen of the United States (NRA transferor). For purposes of this section, an individual is a resident or citizen of the United States if that individual is a resident or citizen of the United States under the rules of chapter 11 or 12 of the Internal Revenue Code, as the case may be. Every NRA transferor is allowed a GST exemption of \$1,000,000. See § 26.2632-1 regarding the allocation of the exemption.

(b) *Transfers subject to chapter 13—(1) Direct skips.* A transfer by a NRA transferor is a direct skip subject to chapter 13 only to the extent that the transfer is subject to the Federal estate or gift tax within the meaning of § 26.2652-1(a)(2). See § 26.2612-1(a) for the definition of direct skip.

(2) *Taxable distributions and taxable terminations.* Chapter 13 applies to a taxable distribution or a taxable termination to the extent that the initial transfer of property to the trust by a NRA transferor, whether during life or at death, was subject to the Federal estate or gift tax within the meaning of § 26.2652-1(a)(2). See § 26.2612-1(b) for the definition of a taxable termination and § 26.2612-1(c) for the definition of a taxable distribution.

(c) *Trusts funded in part with property subject to chapter 13 and in part with property not subject to chapter 13—(1) In general.* If a single trust created by a NRA transferor is in part subject to chapter 13 under the rules of paragraph (b) of this section and in part not subject to chapter 13, the applicable fraction with respect to the trust is determined as of the date of the transfer, except as provided in paragraph (c)(3) of this section.